# Futuregrowth Power Debt Fund

**Developmental & Social Impact Bi-annual Report**
**30 September 2022**

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/ ASSET MANAGEMENT

PHOTO: Noupoort Wind Farm

# THE ENERGY SECTOR IS POISED TO TRANSFORM

Eskom's chief executive officer Andre de Ruyter recently outlined the country's need to spend close to R1.2 trillion over the next ten years (or almost six times the amount to date) in additional energy investment to ensure sufficient generation, transmission and distribution capacity to meet the demand. Much of this capital will be required for the construction of renewable energy as part of the planned energy mix to replace more than 10 GW of coal power scheduled to be decommissioned by 2030.


PHOTO: Coal powered station - source acdi.uct.ac.za

# An exciting & challenging inflection point in our energy future


PHOTO: Kathu Solar PV

Over the past ten years at least R200 billion has been invested in building renewable energy projects in South Africa under the initial four bid windows of the government's REIPPP Programme.

Whilst the country has been battling the costs of increased load shedding, there have been some encouraging steps forward in terms of opening up the sector to private power investment. Several far-reaching interventions have been announced by government, including a doubling in the energy allocation for the next bid window of the REIPPP Programme, the scrapping of the 100 MW licence exemption threshold for distributed generators that will allow uncapped new power plants to be constructed by the private sector and a proposed feed-in tariff for self-generating households and businesses.

However, South Africa is running out of time to act given the deteriorating performance of Eskom's aging power plants and significant cost to the economy for every stage of load shedding. Progress by government with implementing the new energy plans has been frustratingly slow and, in the meantime, the private sector has pushed ahead with their preparations to construct these projects in expectation of the required regulatory processes with NERSA and Eskom being concluded soon.

It is no secret that Eskom's historical dominance in supplying South Africa's energy needs from its own generation plants is on a managed decline. Nonetheless, the utility will still have an important role to play in the energy landscape in future, by managing the national transmission network, repurposing its existing coal stations and leasing its grid-ready land to private power projects, including renewables and natural gas driven technology. Battery storage investment proposals from the private sector are also in the planned power procurement plans for Eskom.

## In this report

In this seventh bi-annual report, we look more closely at the planned interventions to arrest the seemingly dire energy situation in South Africa, compared to actual progress made to date. Some of the delays are due to government's slow decision-making and implementation of their announced plans. But others are due to global factors beyond our control that have negatively affected supply chains for foreign manufactured equipment, together with an exorbitant rise in shipping costs.

In summary we are at an exciting, albeit challenging, inflection point in our energy future, where we expect to see a radical increase in private power activity and significant investment of new fixed capital over the ensuing years.

**Paul Semple**
Portfolio Manager

# The reality of SA's electricity crisis

## Part of a perfect storm of failures in the energy sector

South Africa's power sector is navigating an almost perfect storm of a growing electricity supply deficit, exacerbated by Eskom's deteriorating generation because of increasingly unreliable coal plants, resulting in skyrocketing electricity prices. Together, these forces are crippling the economy.

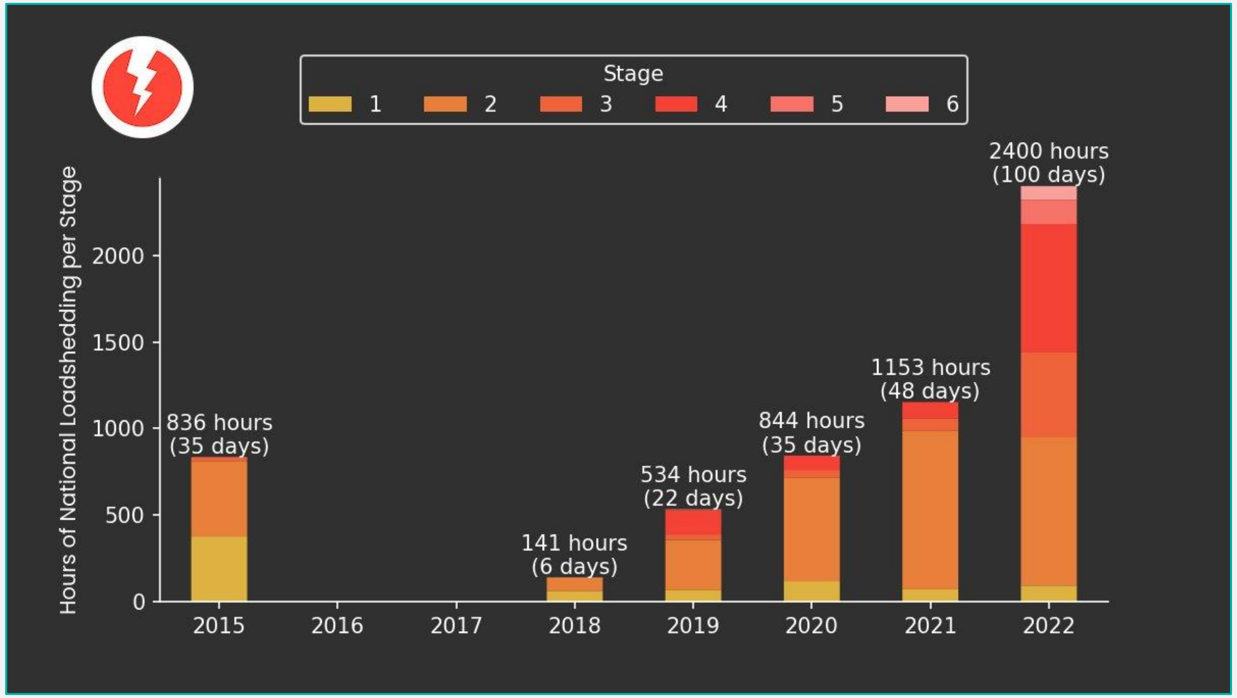
With the country emerging from a COVID-induced economic slowdown over the past two years, it is becoming clear that we have been lulled into a false sense of progress regarding the rollout of new energy generation.

The stark reality of the situation is alarming, with almost weekly load shedding and the possibility of stage 8 recently mentioned by the government. We are on track to break another record for the worst year of load shedding. By Eskom's own admission, load shedding so far for 2022 has already exceeded its predictions and is set to worsen in the months ahead.

Given the delayed roll-out of the emergency power procurement plan set to start a year ago and due to come online this month, Eskom has been forced to rely even more heavily on its diesel-fueled generators, at an enormous cost to the utility and ultimately the tax-payer. South Africa also faces growing pressure to transition to clean energy to meet environmental commitments and avoid punitive international trade terms.

*See full article: [www.futuregrowth.co.za/insights/the-reality-of-sa-s-electricity-crisis](www.futuregrowth.co.za/insights/the-reality-of-sa-s-electricity-crisis)*

**HOURS OF LOAD SHEDDING FROM 2015 TO 2022**




Source: EskomSePush twitter page

# The reality of SA's electricity crisis

## Execution stalls and costs soar

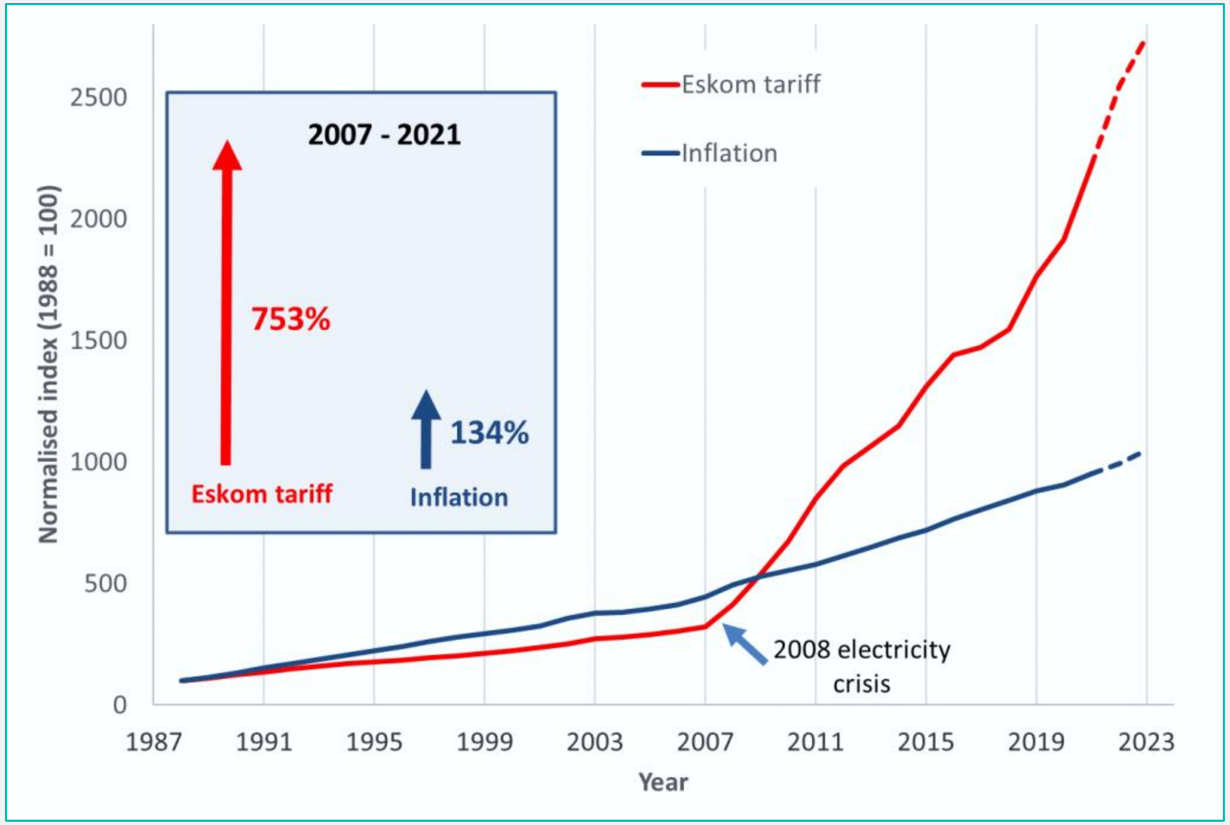
The first three projects under the RMIPPP programme concluded Power Purchase Agreements by Eskom in early June 2022, with financial close shortly thereafter, but most of the programme has stalled. Environmental issues and litigation plague the Karpowerships, and the pass-through of gas costs are now prohibitively expensive for Eskom.

Many REIPPP Round 5 projects are struggling to close, given the significant price adjustments of engineering, procurement and construction contracts against the backdrop of the tight margins bid under the REIPPP programme. Despite already having registered with Nersa, dozens of new private power projects have delayed the start of their construction whilst waiting for clarity about connecting to Eskom's national grid for purposes of selling power to corporate and industrial off-takers.

The capacity of Eskom's national transmission grid is highly constrained in the Northern and Western Cape, limiting the potential for new projects to connect to the grid. Furthermore, the reliability of Eskom's coal plants is rapidly deteriorating.

Eskom's Energy Availability Factor (EAF) for the year to date has averaged less than 60%, and the trajectory is increasingly moving in the opposite direction to the 75% targeted EAF that was envisioned in the government's plans under the "Roadmap for Eskom in a Reformed Electricity Supply Industry". The increasing cost of maintaining Eskom's aging assets, together with the huge cost over-runs and interventions to address design flaws of mega coal plants Medupi and Kusile, has driven up the real cost of electricity by more than 600% over the past 15 years.

**ESKOM AVERAGE TARIFF VS. INFLATION (CPI)**




Source: 2022 update: Eskom tariff increases vs inflation since 1988 (with projections to 2024) - PowerOptimal - the Future of Energy

**Note**: The graph depicts overall average increases – actual increases will be different for different types of consumers (residential, commercial and industrial) and will vary between municipalities.



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# The reality of SA's electricity crisis

## How do we turn this dire situation around?

We urgently need to simplify and fast track the approvals to connect private embedded generation projects to the national grid through better coordination among Nersa, Eskom, the Department of Mineral Resources and Energy (responsible for electricity procurement), the Department of Public Enterprises (responsible for Eskom) and National Treasury.

To assist Eskom, private concessions should be given to Independent Power Producers to upgrade parts of the grid network where they need to connect. Independent Power Producers could achieve cost recoveries if the wheeling fees Eskom charges for using its grid network were reduced.

To expedite the financial close of Round 5, consideration should be given to granting a once-off adjustment to the tariffs to help projects address the unexpected increase in equipment supply costs. Doing so would arguably be cheaper than the cost to the economy for every additional day of load shedding, plus the cost of running diesel generators by Eskom.

Another update to the IRP is needed, given the delays in project closings and performance deterioration in Eskom's coal plants. This should include the increased allocation to electricity procurement from Independent Power Producers by municipalities in good financial standing, expected to be a growing factor in South Africa's electricity sector reform in the years ahead.

A formal plan to facilitate the use of Eskom's infrastructure by municipalities in good financial standing that wish to procure electricity directly from Independent Power Producers, and consumers who wish to sell power into the grid, would greatly assist in rolling out the decentralisation of power away from Eskom generation.

Requirements need to be concluded for Eskom to utilise the $8.5 billion climate finance deal unveiled at the United Nations Climate Change Conference (COP26) in late 2021. This capital could be applied in a variety of uses such as grid upgrade expenditure or renewable investments by Eskom.

The updated IRP should include an increase in the speed and scale of developing additional renewables and battery storage.

### Execution of these plans is the key to a brighter future

There is an urgent need to fast track the build-out of new power generation to minimise the reliance on Eskom's coal plants and reduce the negative impacts of load shedding. Many positive factors support energy reform, including the extensive national grid infrastructure, significant amounts of private investment in the pipeline, South Africa's vast natural resources, and global support for the clean energy transition.

The key issue is prioritising, coordinating and executing decisions that are primarily still on paper. We cannot afford further delays; this is a national emergency for South Africa. We need to do more, faster. However, inflexible regulatory paradigms restrict private sector investors who have the capital, expertise, and the will to make a difference. Significant capital investment is required to upgrade/strengthen the grid. It cannot be left up to Eskom alone and offers an opportunity for public-private partnerships that will ultimately lead to a brighter future for our country.

# Fund facts

## Specialising in renewable energy investments

| | |
|---|---|
| Portfolio manager | Paul Semple |
| Benchmark | South African STeFI Composite Index (STeFI) |
| Performance target | STeFI + 2.25% per annum before the deduction of taxes and fees, with income reinvested |
| Reg 28 classification | Debt instruments, predominantly unlisted instruments of unlisted entities |
| Investment focus | Debt and fixed income in energy related industries and sectors |
| Minimum investment | R50 million (at the manager's discretion) |
| Asset class | Fixed & variable rate debt instruments |
| Current structure | Pooled, open-ended |
| Fund start date | January 2013 |
| Total Fund assets | R9.827 billion |
| Termination period | 12 months (size dependent) |

The Futuregrowth Power Debt Fund specialises in energy-related industries and sectors, and forms part of Futuregrowth's suite of developmental investments.

The Fund may invest in a wide range of debt instruments including those issued by government, parastatals and corporates, as well as securitised assets. The inclusion of assets is subject to credit committee approval.

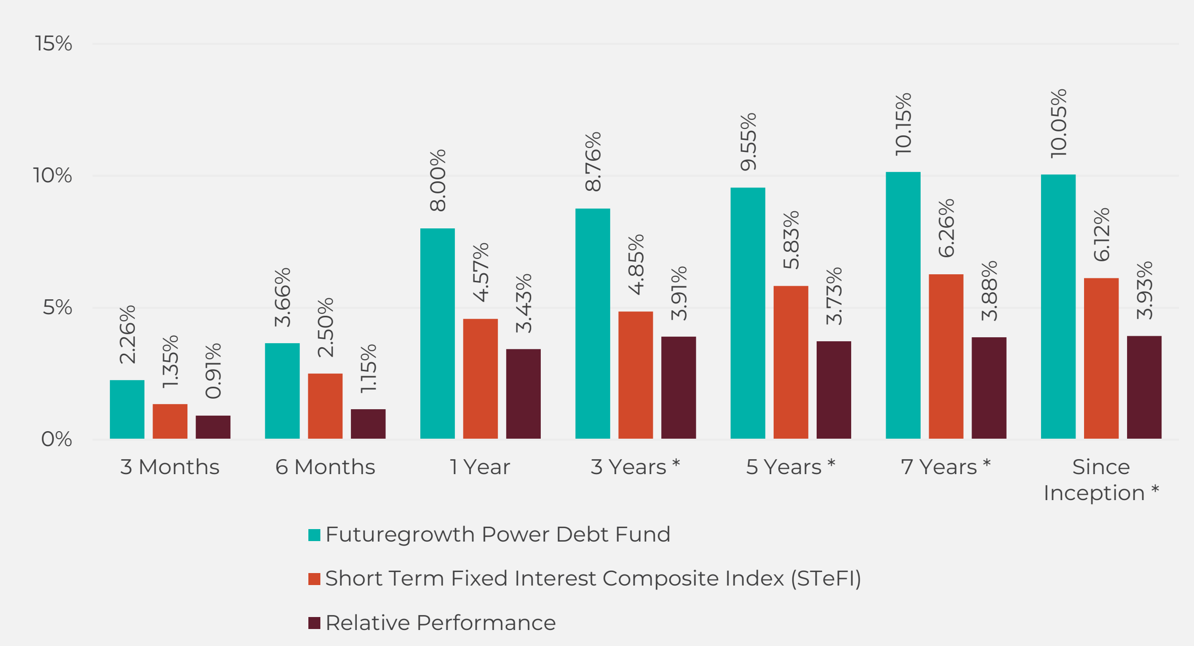
The Fund is largely invested in renewable energy deals that form part of the Department of Energy's Renewable Energy Independent Power Producer Procurement Programme (REIPPPP). All projects under the REIPPPP enter into an off-take purchase agreement with Eskom for the power they will produce during the next 20 years and these revenue streams will be used by the projects to repay the debt finance.

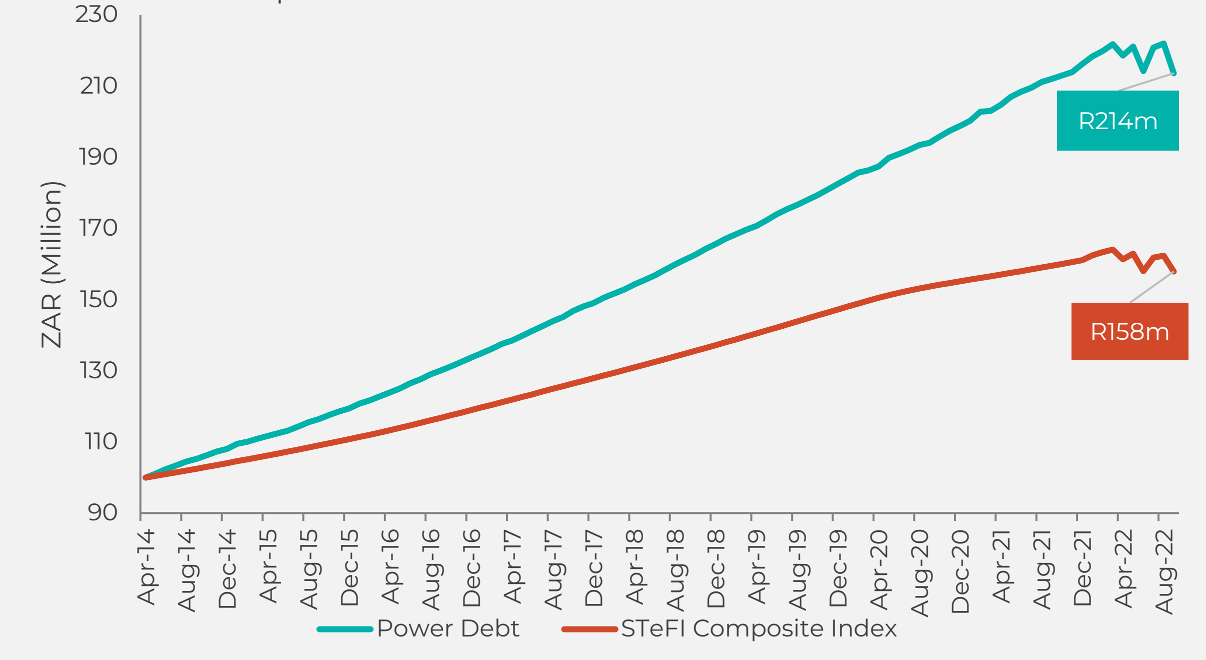
The Fund aims to provide investors with a vehicle that facilitates infrastructural, social, environmental and economic development in southern Africa through investments in energy-related businesses and sectors. These include electricity generation from renewable, alternative and traditional sources, power distribution and reticulation, and supporting industries and sectors.

The Fund delivers on a variety of social impact requirements such as: job creation through employing local labour to build and maintain the plants, SMME development through employing contractors, mentorship and skills transfer from international developers, meeting BEE equity requirements , investment by the projects into local socio-economic infrastructure and services, and compliance with the international Equator Principles.

# Investment performance

## Credit spread accrual is the main contributor




Data as 30 September 2022 // Since inception date (GIPS Composite): May 2014
Fund start date: December 2012 // Source: Futuregrowth // *Annualised

The Power Debt Fund performance was attributed mainly to credit spread accrual earned on the debt deals secured over thirty-two renewable energy projects awarded under the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP). New debt issuance in the market remained subdued given the challenges to achieve financial close by preferred bidders under the recent REIPPPP Bid Window 5 and the Emergency Round, respectively. The nominal interest rate position of the Fund detracted from performance as interest rates moved higher to account for the synchronised monetary policy hiking cycle by developed market central banks to ward off persistent consumer price inflation. The Fund’s inflation-linked bond and floating rate exposure positively contributed to quarterly relative returns. Over the past year, there has been a contraction in the average yield enhancement due to the refinance of debt deals at reduced interest margins by eleven REIPPPP projects investments held by the Fund. The performance of these projects is now largely established, with most evidencing at least seven years of operations. The refinanced debt reflects the improved risk profile and the shorter remaining term to maturity compared to the original debt profiles.

# Key qualifying criteria for projects under the REIPPP programme

The REIPPPP was born in 2012 out of a need and desire to procure alternative, sustainable energy, while simultaneously contributing to social and economic development in South Africa. It allows Independent Power Producers (IPPs) to submit competitive bids to design, develop and operate large-scale renewable energy power plants across South Africa. As a pre-requisite for submitting bids to the REIPPPP, IPPs must show how their project will deliver social and economic development for South Africans.

**Bid tariff**

- +/- 70% of the bid evaluation weighted towards the bid tariff.
- Tariffs awarded in later rounds of the programme have dropped significantly compared to the first round.

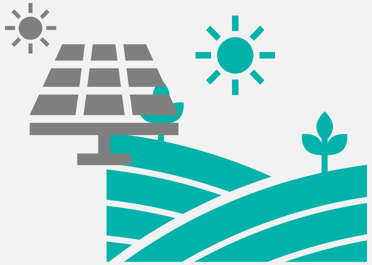
**Local procurement**

- Minimum of 50% of staff must be RSA citizens, with target of 80%.
- At least 45% of the project's construction materials and services must be procured in SA.

**Black & community ownership**

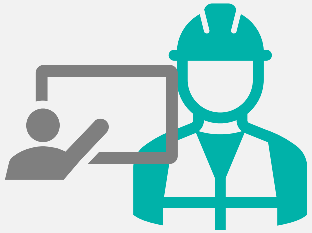
- At least 30% BEE shareholding requirement for the IPP.
- At least 2.5% must be held by a trust representing the local community.

**Clean & renewable generation**



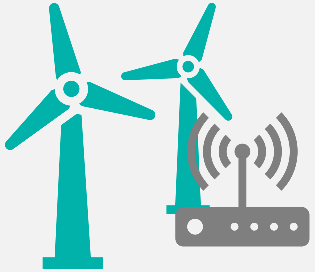
- Environmental Impact Assessment of the proposed site and impact of the project required.
- Renewable energy projects do not use fossil fuels, create toxic emissions or hazardous waste.

**Employment & skills transfer**



- Many international developers have partnered with local firms to develop projects, resulting in a high level of mentorship and skills transfer from the international developers.

**Infrastructural investment & empowerment**



- Many of the projects are constructed in remote arid areas where access roads are required for the construction and operation of the project.
- BEE requirements result in local community empowerment.

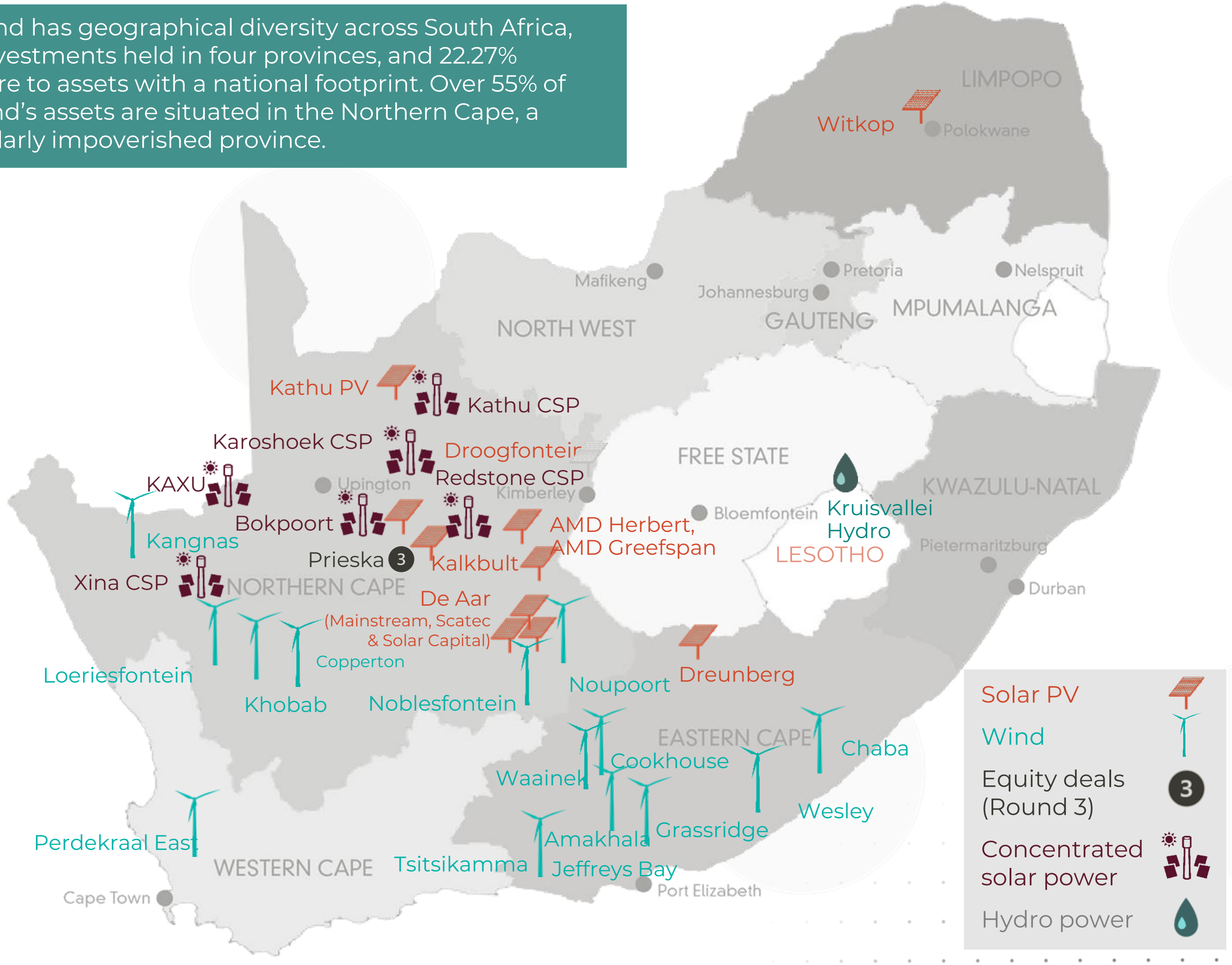
# Geographic diversity & technology capacity

The Fund is invested in a diversity of renewable energy deals, with **R8 billion** in committed deals across 31 projects (out of 117 awarded PPAs under REIPPPP Bid Windows 1 - 5).

| | |
|---|---|
| Wind R4.4bn | 1 429 MW |
| Solar PV R1.6bn | 462 MW |
| Solar CSP R2.4bn | 550 MW |
| Small Hydro R0.1bn | 3.8 MW |

| Region | % exposure |
|---|---|
| Northern Cape | 55.29% |
| Eastern Cape | 15.42% |
| Western Cape | 4.84% |
| Limpopo | 1.57% |
| Lesotho | 0.60% |
| National | 22.27% |
| Total | 100% |

The Fund has geographical diversity across South Africa, with investments held in four provinces, and 22.27% exposure to assets with a national footprint. Over 55% of the Fund's assets are situated in the Northern Cape, a particularly impoverished province.

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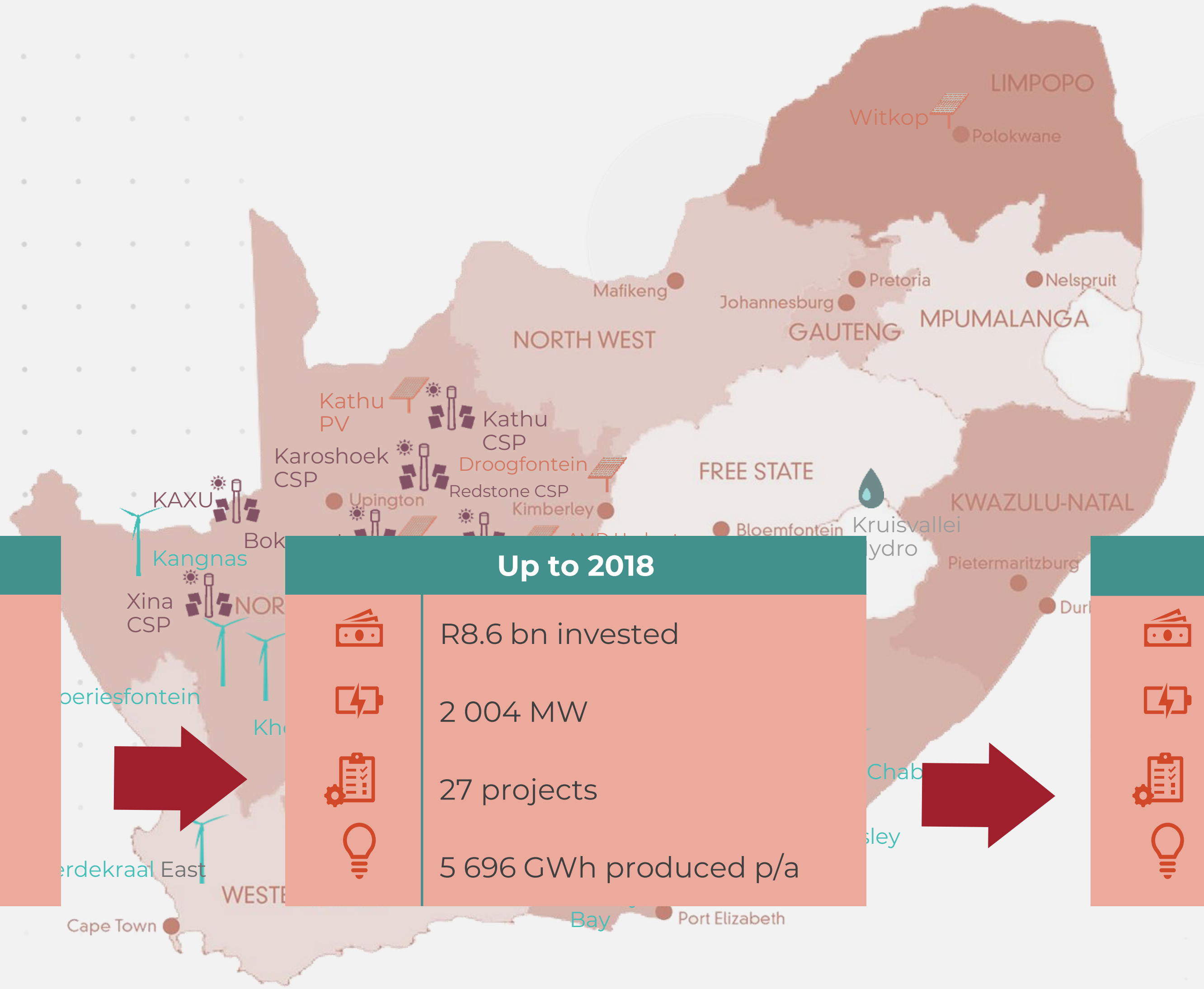
# Transitioning to a green economy through renewable energy




| 2012-2015 |
|---|
| R6.5 bn invested |
| 1 546 MW |
| 22 projects |
| 4 157 GWh produced p/a |

| Up to 2018 |
|---|
| R8.6 bn invested |
| 2 004 MW |
| 27 projects |
| 5 696 GWh produced p/a |

| As at September 2022 |
|---|
| R9.7 bn invested |
| 2 445 MW |
| 31 projects |
| 7 393 GWh produced p/a |

Futuregrowth Power Debt Fund as at 30 September 2022

# Our developmental investment philosophy

## Developmental product suite

Futuregrowth has a 25-year-plus track record of investing in developmental assets. Our funds provide finance to institutions that may not typically receive support from the traditional banking or lending process. In addition to providing finance (credit), we also invest in equity and retail property with a developmental nature.

Our developmental funds are part of our broader responsible investment strategy and reflect the intention of our clients to do good by investing consciously to make a positive impact on society and the broader environment, and thereby to safeguard our collective future.

*Our suite of developmental funds consists of:*

- **Fixed Income** (Infrastructure & Development Bond Fund, Power Debt Fund, Inflation-Linked Debt Fund);
- **Unlisted equity** (Development Equity Fund, Agri Funds);
- **Unlisted retail property** (Community Property Fund); and
- **Fund of funds** incorporating our suite of development funds as building blocks (Developmental Balanced Fund).

Futuregrowth is dedicated to the development and empowerment of South Africa and its people. We are constantly looking for opportunities that will yield optimal financial returns for investors while making a meaningful difference. As such, we have become a reliable channel for investor savings and promoting national development.

We define developmental investing as financing that a) provides investors with commercial returns and b) produces a social and developmental impact. In South Africa the primary focus is on the provision of basic services and improvement of infrastructure development.

In order to achieve sustainable, long-term, benchmark-beating performance, we apply a responsible investment filter when screening and analysing new deals for our developmental funds. This is supported by a robust credit process that considers both financial and non-financial risks.

## Global contribution

We are also aligned with the UN's Sustainable Development Goals (SDGs), thus contributing to this global "blueprint to achieve a better and more sustainable future for all". The SDGs are covered in detail later in this report, where we link the activities of each deal featured to these global targets.

*(See: www.un.org/sustainabledevelopment/sustainable-development-goals/)*

# How we measure and manage impact

**Futuregrowth actively measures and manages for impact. Our impact measurement and management approach is aligned with both global and local development frameworks.**

### National Development Plan (NDP)

This is a long-term development framework for the elimination of poverty and reducing inequality in South Africa by 2030.

### UN Sustainable Development Goals (SDGs)

These goals represent the globally agreed 2030 agenda and are a call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity.

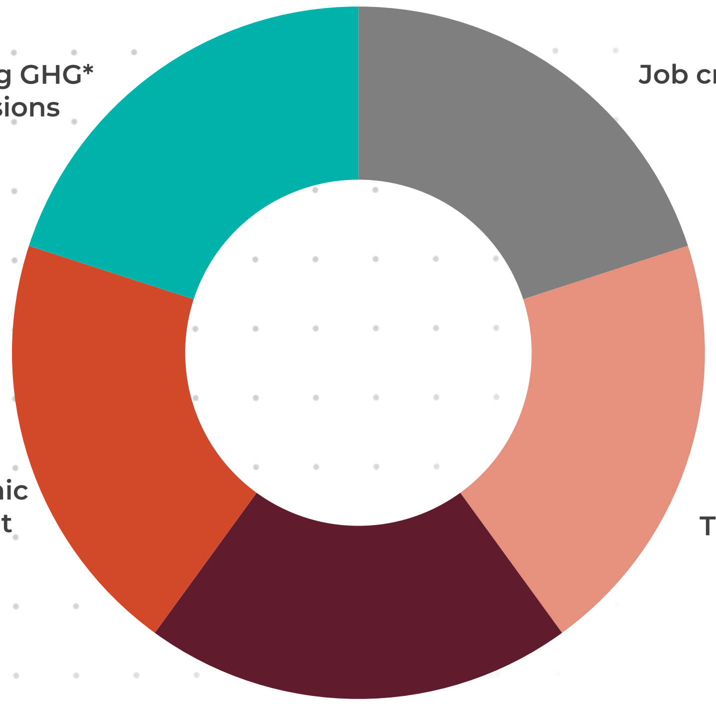
### Principles for Responsible Investing (PRI)

Futuregrowth is a signatory to the Principles for Responsible Investment (PRI), which is an international network of signatories contributing to developing a more sustainable global financial system by incorporating six defined Principles for Responsible Investment into investment practice.

# Priority outcomes & KPIs

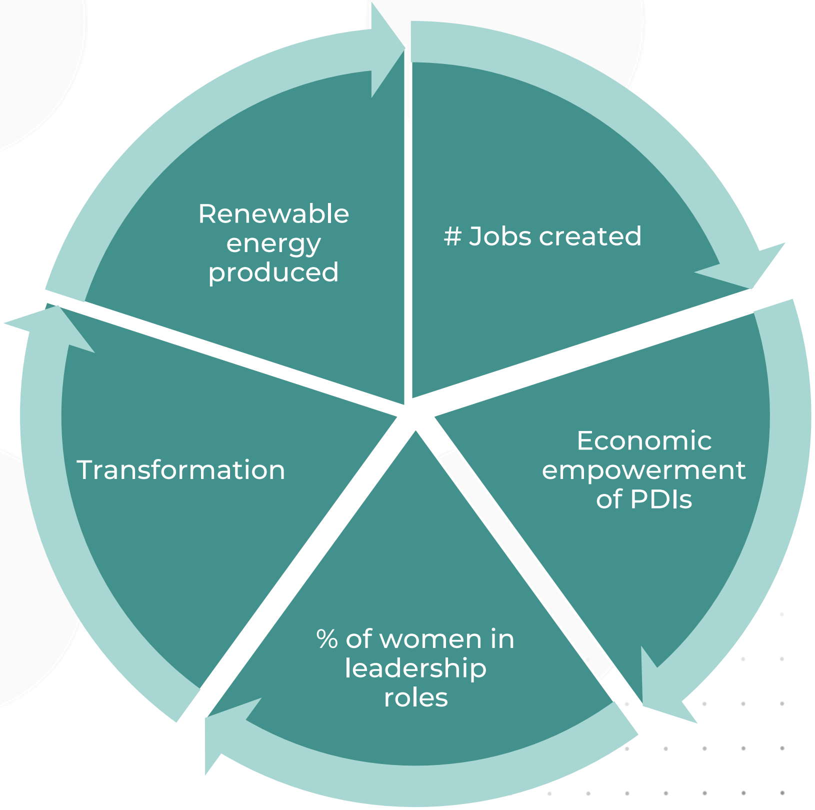
**We have priority outcomes that reflect the critical social and economic changes our clients and stakeholders would like to see. Throughout our engagement with companies, we track core metrics, using key performance indicators (KPIs) outlined below, which can be reported on a company, sector, portfolio (Fund) and aggregated AUM level - to enable us to report on the impact achieved.**

## PRIORITY OUTCOMES




*Greenhouse Gas*

## KEY PERFORMANCE INDICATORS (KPIS)

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# The Futuregrowth Power Debt Fund

## Making a meaningful impact

**KaXu Solar One** plant in the Northern Cape stepped in to fund much-needed teacher assistants for the local community's schools.

**De Aar Solar Power** is funding the Big Shake-up Accelerator Programme, a rural training programme that aims to equip entrepreneurs with opportunities and skills to run a business, regardless of their level of education.

**Red Rocket** is committed to supporting communities in the Clarens/Kgubetswana region through the **Kruisvallei Hydro Project** through initiatives that create jobs and better opportunities for all residents.

**Loeriesfontein Wind Farm**: Is reducing the proportion of youth not in employment, education or training through its academic support programmes.

**Droogfontein's** socio-economic and enterprise development (SED) programmes have invested in various educational programmes, including early childhood development, school literacy and numeracy support programmes and health services.

# Social & developmental impact across the Fund

## Job creation

**1 043** Direct jobs created

**6 168** Indirect jobs created

**83%** Of jobs created are held by blacks

**51%** Of jobs created are held by youth

## Development impact

**R258m** Total spend on Socio-Economic Development (SED) and Enterprise Development (ED)

**133** Total number of projects supported through SED and ED spend

**212** Total number of SMMEs supported through SED and ED initiatives

## The Fund's IMPACT across SDGs

Our clients' investments contribute directly to six SDGs

- 7 AFFORDABLE AND CLEAN ENERGY
- 8 DECENT WORK AND ECONOMIC GROWTH
- 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
- 10 REDUCED INEQUALITIES
- 12 RESPONSIBLE CONSUMPTION AND PRODUCTION
- 13 CLIMATE ACTION

Disclaimer: Data collected in August 2021 from a sample of 28 investee companies in the Fund

# Developing communities

**The launch of the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) has unlocked opportunities for social and economic development for the communities within close proximity to the renewable energy projects.**

Through sources of grant funding and financing exciting opportunities, the projects are creating jobs and resulting in much needed socio-economic development in the communities they are located in, which are typically situated in remote areas of South Africa that mired in poverty and don't have many opportunities for social upliftment and economic growth.

Community development is a pre-requisite for all projects under the REIPPPP. Each renewable energy project contributes a percentage of its revenues towards Socio-Economic Development (SED) and/or Enterprise Development (ED) initiatives within a 50 km radius from the project, with the aim to create a lasting improvement in the living standards of the people in the local community.

Some of the projects supported through the SED and/or ED spend in the Power Debt Fund include:

- SMME development
- Mentorship, coaching and development capital to empower small businesses and projects
- Initiatives that have a significant impact on the lives of young people
- Internship programmes that promote skills transfer and the creation of employment opportunities
- Development capital for the implementation of education, health, sports, arts and cultural programmes.

Since the launch of the REIPPPP in 2011, Futuregrowth (on behalf of its clients) has financed 31 renewable energy projects with investments held in five provinces across different technologies. Futuregrowth recognises the positive impact these power projects play in developing communities and we actively track and report on the SED and/or ED spend, and various initiatives supported by these projects as demonstrated in page 16 of this report.

# Socio-Economic Development (SED) and Enterprise Development (ED) spend

## SDG contribution of SED and/or ED spend

**SDG 1**: End poverty in all its forms everywhere..

**1.4:** "By 2030, ensure that all men and women, in particular the poor and the vulnerable, have equal rights to economic resources, as well as access to basic services, ownership and control over land and other forms of property, inheritance, natural resources, appropriate new technology and financial services, including microfinance".

**SDG 8**: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all..

**8.5:** "By 2030, achieve full and productive employment and decent work for all women and men, including for young people and persons with disabilities, and equal pay for work of equal value".

**SDG 9:** Promote financial, social and economic inclusion for all in order to promote inclusive growth and reduce inequalities..

**9.3:** "Increase the access of small-scale industrial and other enterprises, in particular in developing countries, to financial services, including affordable credit, and their integration into value chains and markets".

**SDG 10:** Create an enabling environment for local businesses, both big and small to reach consumers easily without limitations..

**10.2:** "By 2030, empower and promote the social, economic and political inclusion of all, irrespective of age, sex, disability, race, ethnicity, origin, religion or economic or other status".

# Key features Power Debt Fund

**R9.827bn**
Fund size

Commercial
**risk-adjusted**
returns

**Investments in**
electricity generation from renewable and alternative sources

Active in
**4 provinces**

## Job creation

- Employing local labour to build and maintain the plants;
- Short- and long-term job creation; and
- SMME development through employing contractors.

**Over 88%** of the Fund is invested in rural areas

## Skills transfer

- High level of mentorship and skills transfer from international developers; and
- International developers partnering with local firms.

Supports **six Sustainable Development Goals**

Futuregrowth Power Debt Fund as at 30 September 2022

# Contact information

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